Money laundering: private banking becomes less private

By Michael Levi

Introduction

Criminals, whether narcotics dealers or corrupt heads of state, have long used secret accounts, trusts in false names and other devices to launder the proceeds of their crimes. An estimated US $500 billion to US $1.5 trillion are laundered through banks each year[1] – though these figures include huge transaction costs and consumables and do not represent net criminal savings. Now, as national and international regulators start to enforce new banking rules and the banking industry is beginning to respond with its own voluntary efforts, there are fewer places where the proceeds of crime can be hidden without risk of exposure.

Prominent cases have demonstrated just how recent these changes are. In the late 1980s, Citibank in London accepted as clients two young 'commodity and oil dealers', Ibrahim and Mohamed Sani Abacha. Bank files recorded the brothers as the sons of Zachary Abacha, 'a well-connected and respected member of the northern Nigerian community', but no mention was made that Abacha senior (later head of state) was a general in the Nigerian army and chairman of the country's Joint Chiefs of Staff.[2] By 1998, the Sani Abachas had deposited US $60 million with Citibank.[3]

The Sani Abachas and other members of the Abacha circle allegedly stole an estimated US $4.3 billion over a number of years – about half of it from the Nigerian central bank. The web of banks and jurisdictions implicated in these thefts is wide and tangled. So far, more than US $1.4 billion has been found and frozen in banks in Liechtenstein, Luxembourg and Switzerland.

In September 2000, the Swiss Federal Banking Commission 'named and shamed' leading banks in Switzerland, including Crédit Suisse, for 'serious failures' in allowing the Abacha clan to amass US $660 million. Numerous middle-ranking employees left the industry, sending the signal to others that this kind of laxity could affect them personally. Further, Swiss investigators found US $123 million of the funds had originally come from the UK – some allegedly as bribes from UK companies. Investigators also discovered that a further US $219 million had been transferred out of Switzerland again to British banks.

In March 2001, the UK Financial Services Authority (FSA) determined that,

though some suspicious transaction reports had been made by various banks to the National Criminal Intelligence Service, 15 of the 23 banks dealing with the Abacha family funds had 'significant' control weaknesses.[4] None of the banks was named, as the FSA did not then have the legislative provision to do so.[5] At the time of going to print, it remained to be seen what the follow-up would be.[6]

How seriously should the ramifications of the Abacha affair be taken, or those that have emerged around Benazir Bhutto, Ferdinand Marcos, Mobutu Sese Seko, or Papa Doc and Baby Doc Duvalier? What will be the result of investigations into the African bribery aspects of the French Elf Aquitaine affair? What are the implications for private banking, for the corporations and high net-worth individuals who are traditional private banking clients, and for the governments that need to regulate an industry that is notoriously secretive and yet global in scope? What do these cases, and the recent responses to them, mean for the worldwide fight against corruption?

Money laundering and its links to corruption

Money laundering typically evokes images of major international financial manipulation, with a depositor using myriad offshore bank and trust company accounts in places resistant to investigation. Legally, however, money laundering can consist of nothing more than depositing the proceeds of crime in a domestic bank account. The difficulty of recognising funds as the proceeds of crime is compounded by the vast sums involved: trillions of dollars move around the world daily, and banks and others do no more than technically process these.[7]

A review of money laundering conducted for the UN illustrates the use of trusts, international business corporations and free trade zones for laundering schemes.[8] Proceeds of corruption can be laundered to avoid exchange control restrictions, and these overseas funds can then be loaned to international business people to facilitate their legitimate trade. Devices such as 'walking trust accounts' – accounts that move automatically to another jurisdiction when inquiries or mutual assistance requests are made – clearly facilitate crime. They also inhibit responses, by making it much more difficult and expensive to pursue suspected offenders for either evidence or recompense.

Money laundering (like organised crime) is more often associated with drugs than with elite crime, such as the theft of state assets or inter-corporate bribery. But while the war on drugs has dominated international legal and practical changes in money laundering and in the confiscation of assets, cases of grand corruption have also been important in shaping regulatory efforts. Since the 1970s, for instance, grand corruption has influenced Swiss measures for due diligence.

Without money laundering, there would still be corruption, but bribes would have to be paid (and held) in cash or readily movable valuables such as gold, diamonds and art. Not all bribes received have to be laundered: some cash can be redistributed as 'grease' payments or simply spent. Corrupt public and corporate officials, as well as other criminals, often use laundering agents, relying on them to show discretion in handling funds – and to be uncooperative in any criminal investigations that might arise.

Unfortunately, laundering only needs to be good enough to defeat the capacity of financial investigation skills and the burden of proof in any of the jurisdictions along its economic path. But though financial investigators may not be able to find out where assets are, or who owns them, they can at least make it hard for traffickers and launderers to collect the money.

Evidence suggests that it is now more expensive than ever to launder money. The costs of laundering are thought to have risen from 6 to 8 per cent of transaction values at the beginning of the 1980s, to as much as 20 per cent by the mid-1990s.[9] According to a US law enforcement source, costs rose substantially again by 2000–01, at least in the drugs sector.[10] Unfortunately, these higher costs do not indicate whether the actual amount of laundering has changed, or whether more 'rent' is being demanded by bankers or others for taking greater risks.

In the case of grand corruption, far less is known about laundering costs. Generally speaking, such costs are not marginal, but they are built into the operations of corporate actors for whom the payment of a few million dollars is routine. As regards corporate actors, the key regulatory role is played by internal and external audit controls – and by penal and reputational risks.

Global initiatives to stop money laundering

Since 1999, pressure to control money laundering has come from all quarters, including international agencies; regulators (the main thrust of regulatory efforts has been to stop dirty money entering the banking system, and to make sure it is traceable if it does); prosecutors, acting as the world's financial policemen; and private sector multinationals acting voluntarily, influenced by concern about reputational risk and the desire to avoid tough regulatory and criminal powers.

FATF, OECD and other international organisations

A major actor has been the Financial Action Task Force on Money Laundering (FATF), an intergovernmental, policy-making body established in 1989 to guide the implementation of anti-money laundering measures in the aftermath of the 1988 UN Drugs Convention.[11] One FATF initiative in June 2000 represented a

Making legislation work in Switzerland

The head of the Money Laundering Reporting Office Switzerland (MROS) resigned in frustration at the end of 2000, followed by all of his colleagues. He had sought in vain government permission to strengthen the power and personnel of the office. The episode illustrated the difficulties encountered in implementing the new Swiss law against money laundering, which came into effect in April 1998.

The law is one of the toughest pieces of anti-money laundering legislation in the world. It aims to tighten cooperation between the private sector and government, through a mandatory but strictly confidential, exchange of information in instances when corruption or criminality is suspected.

The law covers not only banks, but also all financial intermediaries. In the interest of better controls, all banks and financial intermediaries must now register either as members of a recognised self-regulatory organisation, or with a special federal government control office. They are forced by law to declare all suspicious funds to the MROS, which will launch criminal proceedings when necessary.

The law has been difficult to implement. The volume of assets held by Swiss financial institutions is estimated at around US $4,000 billion, yet declarations to the MROS last year only amounted to US $364 million. The 311 declarations made last year since the law came into force amount to less than one declaration per bank. Only 25 per cent of the declarations stem from financial intermediaries, pointing to a possible lack of cooperation.

The obligation to make a declaration to the MROS under the law exists only if a business relationship has been established between a financial institution and the suspect, and then only if there are ‘founded suspicions’. This is not a well-defined notion and allows for many omissions. With regard to the definition of ‘financial intermediaries’, the law is broad, but it omits consideration of certain categories of agent, such as traders in primary goods. Violation of the obligation incurs a fine of up to US $114,000, and/or penal and administrative sanctions.

Another problem lies in the mutual legal assistance procedures, providing for cooperation between states. The entire procedure can be held up at three points if a party ‘objects’ to the way it is being handled. Judicial reform due to be implemented in 2002 should resolve at least one of these problem points.

Meanwhile, the MROS is dramatically under-staffed when faced with the powerful Swiss financial sector, and compared to equivalent bodies in other countries. MROS has a staff of only six, while bodies in France and Italy have over 30 and 60 respectively.

Some of these factors are recognised by the Swiss authorities. But French parliamentarian Arnaud de Montebourg has accused Switzerland of tackling the money laundering issue solely for the sake of appearances. A more benign view might recognise that the difficulties encountered by the law are inevitable teething troubles.

The political structure of Switzerland creates its own set of obstacles. Many different actors are involved in the legal procedures, both at federal and cantonal levels. Among the cantonal authorities, the degree of commitment to cooperate varies from one authority to the next. Upcoming judicial reform will centralise prosecution of money laundering cases at the federal level. But it is not yet clear how this increased demand for federal resources will be met – whether the government will be able to attract former cantonal civil servants (who already have the know-how), or whether it will have to train new personnel.

Given the characteristic of consensus that governs the Swiss political system and the influence of the private sector in parliament, self-regulation may be the only realistic solution. It is too early to determine if this system will be successful.

TI-Switzerland

1 ‘La lutte contre le blanchiment des capitaux en Suisse: un combat de façade,’ Documents d’information de l’assemblée nationale française, 2001.

major shift in efforts to tackle the problem, focusing efforts on country by country review instead of general international pressure and mutual evaluation. After a review by FATF, 15 jurisdictions were declared to be sufficiently 'uncooperative' as to merit economic sanctions if they failed to reform their money laundering laws and procedural implementation by June 2001.[12] One outcome was that the G7 issued formal advisories to these countries' domestic financial institutions to ensure that all transactions from, for example, Israel and Russia (on the so-called FATF 'blacklist'), were legitimate.[13] This led to an enormous effort by some of those countries to reform their laws and, to some extent, their banking practices. Such reform has involved financial regulators as well as legislators and police.

A subsequent FATF meeting in June 2001 focused on criteria for removing jurisdictions from its sanctions list, and reviewing its 40 'principles', such as 'know your customer'. FATF decided to remove some countries from its blacklist (but will closely monitor future developments) but added others.[14] It further recommended that its members apply countermeasures after September 2001 to Nauru, the Philippines and Russia unless their governments enacted significant legislation that addresses FATF-identified money laundering concerns. In future, FATF ought also to address measures against laundering of corruption proceeds.

Due to pressure from FATF and the OECD's Anti-Bribery Convention, corruption and fraud have increasingly been criminalised as money laundering predicates. This is a welcome development, but can be problematic. Although corruption and fraud normally have to be proved in order to sustain a conviction for laundering, mutual legal assistance from certain governments may be hard to obtain where key suspects still exercise local power. Even when financial institutions make a 'suspicious transaction' report, financial investigators may not be able to obtain further information from the overseas jurisdiction. However, the creative interpretation by prosecutors and investigating judges in France, Italy, Spain and Switzerland has meant that, where substantive and evidential rules allow laundering as a separate offence, it is possible for proceedings to take place in another country outside the sphere of influence of the corruption, where there may be some legal protection for suspected offenders. And this in turn can mean the freezing of assets, though – as with the Marcos millions – these assets will generally only finally be confiscated if there is a legal determination of guilt.

Treaties, conventions and regulatory agreements set out a framework, but do not indicate the levels of actual activity against money laundering. Internationally, the favoured anti-laundering strategy to supplement such legal agreements has been that of 'mutual evaluation', which was recently extended to include mutual legal assistance and the proceeds of crime confiscation, both by FATF and by the Council of the EU.[15] Peer evaluation is intended to draw countries into

greater compliance, not least by enabling them to begin developing consistent standards. There is of course a danger of duplication or conflict in such evaluations, as the work of the Council of Europe, FATF, OECD and, potentially, the UN increasingly overlap.[16]

Until recently, the problem with this approach has been that mutual and expert evaluations have failed to focus on the laundering of transnational bribery, since it does not feature in conceptions of 'organised crime'. However, there is now a greater focus on the laundering of corruption proceeds. Evaluations by the joint OECD and Council of Europe Group of States against Corruption (GRECO) are one instance.[17]

Bank for International Settlements

The Bank for International Settlements (BIS), owned by the world's leading central banks, proposed much tougher rules for bank customer identification in a Basel Committee for Banking Supervisors consultation document in January 2001.[18] Stressing that its initiative was wider than the FATF guidelines, the BIS said that voluntary industry codes of conduct were to be encouraged, though 'they are not in themselves sufficient to ensure market integrity or sound risk management'. Further, the BIS argued that if banks did not exercise 'adequate due diligence' on all customers, they could become subject to 'reputational, operational, legal and concentration risks, which can result in significant financial costs'.[19]

The Basel Committee added that 'special attention' should be exercised in the case of non-resident customers who channel their funds through offshore centres: 'The bank should always ask itself why the customer has chosen to open an account in a foreign jurisdiction.'[20] Notwithstanding these bold statements, however, clear guidelines to identify money laundering risks are underdeveloped.

Capital flight and its effects on the stability of the world banking system have always been of concern to the BIS. In recent years the connection between capital flight and the proceeds of crime has generated additional motivation for action because of the relationship between integrity and stability.

Wolfsberg Principles

One of the aims of anti-laundering measures is to encourage bankers and others to know their clients sufficiently well to be able both to identify and report suspicious transactions. Few bankers know what types of crime – if any – their customers may be engaged in. If clients fool bankers or lawyers into believing that, at most, their deposited funds constitute 'merely' tax avoidance, then no suspicious transaction report on corruption will be made.[21] A crucial step is that all crimes need to be included within the obligation to report suspicious funds.

Tax havens, corruption and poverty[1]

It has been estimated that the equivalent of one third of one year's global GDP is held in tax havens. Much of this wealth is undisclosed and untaxed. The 'offshore' world provides a safe haven for the proceeds of political corruption, illicit arms dealing, illegal diamond trafficking and the global drug trade. Governments everywhere are increasingly concerned about the tax loss and money laundering associated with tax havens. This has led to a proliferation of initiatives designed to tackle different aspects of the problem.

Oxfam's view is that while these initiatives are useful up to a point, they primarily reflect the concerns of northern governments and, consequently, lack a poverty perspective. The OECD crackdown, for instance, has principally focused on tax havens in developing countries. But financial havens are part of a wider problem extending beyond the offshore activity of small island states to 'onshore' activity in major financial centres such as London and New York.

Tax havens may seem far removed from the problem of poverty, but they are intimately connected. Corruption, and the secretive system that facilitates it, denies people in developing countries the right to just public policies, with devastating implications for the very poor.

Tax havens provide companies and wealthy individuals with a way of escaping their tax obligations, thereby limiting the ability of governments to raise revenue and make vital investments.

The secrecy space provided by the 'offshore interface' between criminal activity and the world of legitimate financial transactions has become a crucial element of modern crime and a vital enabling mechanism for corruption.[2] The use of financial havens to launder the proceeds of corruption is an important issue for both national and global governance.

Money laundering facilitates public corruption. In the developing countries, some of the most notorious clients of the international private banking industry are those in or close to political office. In 1999, *The Economist* estimated that African leaders had accumulated US $20 billion in Swiss bank accounts alone over the decades.[3] To put this in context, this is nearly twice the amount that Sub-Saharan Africa spends servicing its debt annually.[4]

Research to discover workable policy options is a vital part of Oxfam's advocacy programme to increase finance for development.[5] To tackle money laundering, Oxfam recommends that a multilateral agreement to share information on tax matters would help countries, especially poorer ones, to stem tax evasion and illicit activities.

The international community should also support the proposal for an international convention to facilitate the recovery and repatriation of funds illegally appropriated from national treasuries. African, Caribbean and Pacific heads of state and government adopted such a proposal in November 1999 as part of the Santo Domingo Declaration.[6]

Oxfam

1. This is an updated extract from the Oxfam briefing paper 'Tax Havens: Releasing the Hidden Billions for Poverty Eradication,' June 2000. Available on the Oxfam website <http://www.oxfam.org.uk>.
2. Mark Hampton, *The Offshore Interface: Tax Havens in the Global Economy* (Basingstoke: Macmillan, 1996).
3. *The Economist* (UK), 14 January 1999.
4. According to the campaign group Drop the Debt, Sub-Saharan Africa spends US $13.6 billion per year on debt-servicing: <http://www.dropthedebt.org>.
5. For a broader discussion on policy options addressing problems associated with tax havens and offshore centres, see Oxfam (2000).
6. More recently, in March 2001, TI chapters in 11 African countries signed the Nyanga Declaration, aimed at spearheading an international campaign for the tracing, recovery and repatriation of Africa's stolen wealth.

In 2000, a group of international private banks, with the participation of Transparency International, engaged in a voluntary effort to control money laundering by cutting across the multiplicity of jurisdictional issues and addressing the serious reputational damage they were suffering in the media because of money laundering. Eleven banks (two have since merged), accounting for at least one third of the world's private banking funds, agreed at Wolfsberg, Switzerland, to establish a common global standard for their private banking operations.

The Wolfsberg Principles include common due diligence or 'know your customer' procedures for opening and keeping watch over accounts, especially those identified as belonging to 'politically exposed persons' (i.e. potentially corrupt public officials). In the case of individuals, if doubt exists as to whether the account holder is the beneficial owner, 'the bank will establish the capacity in which, and on whose behalf, the account holder is acting'. In the case of companies and trusts, 'the private banker will understand the structure of the company [or trust] sufficiently to determine the provider of funds, principal owner(s) of the shares and those who have control over the funds'. A key part of the 'know your customer' review process is to establish the source of funds being placed. The Wolfsberg Principles state that if there is no plausible, legitimate explanation for transactions, a decision will be made to continue the business relationship with increased monitoring; to cancel the business relationship; or to report the business relationship to the authorities. Assets may be blocked and transactions made subject to approval as required by local laws and regulations, which is the case in Germany, Liechtenstein and Switzerland.

The application of these principles retrospectively is a key question for banks. Several have argued that questionable accounts were opened long before due diligence rules were tightened. One way forward is the compilation of a list of public officials, former officials and their families. Yet even if such a 'risk list' was created and carefully maintained, a stronger compliance culture and appropriate account oversight technology is required to ensure suspicious funds are not missed or underreported.

The Wolfsberg signatory banks are in any case subject to supervision by their lead host regulators, but their public commitment to the principles produces a powerful reputational incentive for compliance. The fact that other banks now wish to sign up to the Wolfsberg Principles underlines the extent to which reputational issues have become central to international banking.

Conclusion

It is tempting to be dismissive of the rhetoric of politicians and banking sector leaders. Certainly, the direct, short-term impact of money laundering reporting has been modest in terms of prosecutions and confiscations. This is particularly true with regard to corruption cases, with the partial exception of Switzerland. Arguably, the results from suspicious transaction reporting are not illustrative of the potential of reporting systems. Rather, they reflect the limited resources at present put into such systems by bankers, financial investigators and prosecutors, as well as the difficult legal framework which, as discussed, requires proof of the predicate offence.

Nevertheless, the non-transparent world for financial services is undeniably shrinking: private banking is becoming a little less private. This affects individuals or mafia networks more than it does large corporations, accountants and law firms. The very global spread of the latter does, however, make them more vulnerable to loss (though not yet, it should be noted, to closure), through reputational damage and regulatory sanction. There are some signs that key corporate actors are willing to engage in a Wolfsberg-style commitment to good practice.

Anti-money laundering policies, combined with expanding criminalisation of transnational bribery, have made bribery riskier both for corporate actors and the intended recipients. Such policies also significantly enhance the international transparency of financial transfers, at least after the fact, if not always at the preventive stage.

One of the unintended benefits of recent high-profile cases is that they have pointed to corruption (and the capital flight that sometimes hides corruption), rather than illegal drugs, as a core problem of international crime control. Furthermore, such cases have thrown a spotlight on the private banking sector, where the assets of the richest people typically end up.

The pressures of measures against all-crimes laundering, transnational bribery, transnational organised crime and 'harmful tax competition', and in favour of transparency in offshore finance flows, have eroded national sovereignty in these domains. Less progress has been made to curb the use of corporations, trusts or other devices as secrecy vehicles. This will be the main thrust of future international efforts to curb money laundering. Here, enhanced corporate governance, supported both by external and internal audits is needed, as is the development of warning indicators. It is also crucial to review prominent cases of money laundering with a view to developing realistic guidelines for banking staff and others. Importantly, any guidelines will have to anticipate new countermeasures by those seeking to place corrupt funds. In the battle against money laundering, the continuing shift towards evaluating practice, rather than developing

laws and regulations, will be helpful. However, vigilance against ‘evaluation fatigue’ – leading to resentment rather than reform – must also be maintained.

1 IMF estimates cited in *The Economist* (UK), 21 June 2001.
2 *The Guardian* (UK), 7 October 2001.
3 Citibank London facilitated the opening of new accounts to handle funds from the Sani Abachas’ airline with Citibank New York. The Sani Abachas continued to operate the New York account long after the airline stopped trading.
4 FSA press release, 8 March 2001. The FSA investigation identified 42 personal and corporate account relationships linked to Abacha family members and close associates in the UK, held at 23 banks (both UK banks and branches of banks from both inside and outside the EU). Between 1996 and 2000, total turnover on the 42 accounts amounted to US $1.3 billion – not necessarily proceeds of crime – ending up in the UK, of which some 98 per cent went through the 15 banks with significant control weaknesses.
5 The Financial Services and Markets Act 2000 is due to come into force shortly, and will allow the organisation to name banks in future.
6 In June 2001, the Abacha family won the right to a judicial review of the UK Home Secretary’s decision to cooperate by freezing funds. The family argued that it had already repaid US $800 million to Nigeria in exchange for the lifting of civil and criminal liability, and that the Nigerian government was seeking to recover funds that were not owed to it, without issuing civil proceedings. *Financial Times* (UK), 6 June 2001.
7 The scale of laundering from corruption and other crimes is vast. In the US, the headline figures of forfeitures (almost US $1 billion annually) – much of it from laundering prosecutions – are larger than for the rest of the world combined. Even there, the sums confiscated are very small compared with actual crime proceeds.
8 Jack Blum, Michael Levi, R. Tom Naylor and Phil Williams, ‘Financial Havens, Banking Secrecy and Money Laundering,’ Issue 8, UN Office for Drug Control and Crime Prevention (UNDCP) Technical Series, 1998.
9 Cost assessments here relate directly to the laundering of organised crime assets. UNDCP, *World Drug Report* (Oxford: Oxford University Press, 1997).
10 Interview with author.
11 FATF was originally convened by G7 Heads of State and the President of the European Commission; it is now comprised of 29 countries and two regional organisations.
12 The FATF list comprised Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St Kitts and Nevis, and St Vincent and the Grenadines.
13 G7 Finance Ministers, ‘Actions against Abuse of the Global Financial System,’ report to Heads of State and Government, Okinawa, 21 July 2000.
14 Bahamas, Cayman Islands, Liechtenstein and Panama were removed, while Egypt, Guatemala, Hungary, Indonesia, Myanmar and Nigeria were added.
15 The EU has been actively facilitating international cooperation against organised crime through its new ‘Eurojust’ mechanism, established after the Tampere European Council.
16 For example, the 2001 Council of Europe evaluation of anti-corruption measures in the UK is largely favourable, whereas the 2000 Phase One evaluation by OECD is quite negative. Of course, different criteria can be used, but there is potential for confusion and ‘evaluation shopping’ here. At an even broader level of involvement, there are a number of organisations taking steps to combat money laundering and financial crime that need to coordinate efforts, including Interpol, the IMF and the World Bank. The latter two produced a joint paper in April 2001, ‘Enhancing Contributions To Combating Money Laundering,’ available at <http://www.imf.org/external/np/ml/2001/eng/042601.htm>.
17 GRECO states include those who have signed the Council of Europe’s 1999 Criminal Law Convention on Corruption and agreed to the mutual evaluation process.
18 The Basel Committee lays down rules for regulators internationally and is part of the BIS.
19 Basel Committee on Banking Supervision, ‘Customer Due Diligence by Banks,’ consultative document, January 2001; *Financial Times* (UK), 1 February 2001.
20 *Financial Times* (UK), 1 February 2001.
21 Only if there are ‘objective’ legal liabilities will a suspicious transaction report need to be made.